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SUBJECT: FALLING PETROLEUM PRODUCTION

REF: A. QUITO 321

¶B. 06 QUITO 1722

¶1. (SBU) Summary: Petroleum production in Ecuador will fall appreciably in 2007. The GOE projects production will decline by six percent in 2007; one private sector consultant expects the drop will be eleven percent. The decline is due to falling production in state firm Petroecuador's fields and the former Oxy fields, which have suffered from insufficient investment. Increased production by private petroleum firms had more than offset falling Petroecuador production over the past decade, but in 2007 private sector production may also decline slightly. Most private companies have frozen investment while awaiting potential forced contract renegotiations. End summary.

Falling Production

¶2. (SBU) In the obscure world of Ecuadorian petroleum, even accurate production numbers are hard to come by. The Central Bank reports 2006 production totaled 195.6 million barrels, with average daily production of 536,000 barrels per day (bpd). Of that, 90.4 million barrels were produced by Petroecuador, and 105.2 million barrels were produced by the private sector (note: as of May 16 oil from the former Oxy fields is considered Petroecuador production). However, according to Petroecuador internal data, production was only 188 million barrels in 2006 (90 million Petroecuador; 98 million private sector), with average daily production of 520 bpd.

¶3. (SBU) According to estimates for the GOE budget, total petroleum production in 2007 will fall to 183.7 million barrels (a 6 percent decline). Petroecuador projects that its fields (excluding Oxy's former Block 15) will produce 62 million barrels, a decline of 8 percent from its 2005 production. It also forecast that production from the former Oxy fields will total 33 million barrels in 2007, for a combined Petroecuador production of 95 million barrels. This implies an increase in total Petroecuador production over 2006, but only because it will have control of the former Oxy fields for the entire year. For the former Oxy fields, Petroecuador projects 2007 production at 90,000 bpd in 2007, compared to 100,000 bpd when Oxy controlled the field, a 10 percent decline (Oxy maintains its actual production capacity had been higher, around 110,000-120,000 bpd so the effective decline in capacity has been higher under Petroecuador mismanagement).

¶4. (SBU) Subtracting forecasted Petroecuador production from total

estimated 2007 production suggests that the GOE expects private companies to produce approximately 88.7 million barrels in 2007. For comparison, after subtracting Oxy production from 2006 Central Bank data, private sector companies produced approximately 93.2 million barrels, implying a 5 percent decline in 2007.

¶5. (SBU) However, former energy minister and energy consultant Fernando Santos predicts an even steeper decline than Petroecuador has projected, mainly due to a rapid decline in production from the former Oxy fields. He expects total Petroecuador production to fall to 85.8 million barrels (58.4 million barrels from regular Petroecuador fields and 27.4 million barrels from the former Oxy fields). Folding in the estimate for private sector production, this would put total 2007 oil production at 174.5 million barrels, which would represent an 11 percent decline over 2006.

Lack of Investment Causing Decline

¶6. (SBU) Petroecuador took control of most of its productive fields from Texaco Petroleum in 1990. Only limited maintenance or repairs have been done since. The Ministry of Finance controls Petroecuador's revenues and does not give the state company enough money to invest in substantial maintenance. In addition, the fields were initially installed in the 1970s so the infrastructure is old and obsolete. Block 15 is a very high-tech block with a high concentration of water (wells are quickly saturated with water and unusable) and new wells need to be drilled regularly in order to maintain production. Oxy had planned to invest USD 300 million in the block, and had three drilling rigs and a workover planned for 2006; Petroecuador reportedly wants to drill more wells but the hiring of rigs scheduled for October 2006 is still awaiting government approval. Former Oxy manager Carlos Blum had been running Block 15 since Oxy's contract was nullified but now Wilson Pastor, an old Petroecuador hand, will manage the block.

Private Sector In Holding Pattern

¶7. (SBU) Over the past decade, petroleum production in Ecuador has increased by approximately 40 percent. During that time the private sector share of production has increased from 20 percent of production to 55 percent in 2006. Oxy had been the largest private producer; with its departure the largest private producers are now Repsol (Spanish) and Andes Petroleum (Chinese); each pumps close to 25 percent of private sector production. Other important firms include Petrobras (Brazilian) with 15 percent, and Perenco (French), Agip (Italian), and Sipec (Chilean, each with close to 10 percent of private sector production. Given the uncertainty in the sector, most firms are expecting to hold production steady this year, or even decline slightly.

¶8. (SBU) Repsol is the only private sector company planning significant additional investment in 2007, with plans to drill 33 wells this year. Our understanding is that other companies will only do minimal investment to maintain their current fields.

¶9. (SBU) President Correa and Energy Minister Acosta have criticized the current production sharing contracts between the GOE and private sector producers (reftel A). However, they have not been clear on how they would restructure the contracts, which the prior government was already renegotiating due to the 2006 revision to the hydrocarbons law requiring companies to share "at least 50 percent of extraordinary revenues" with the government (reftel B). This contractual uncertainty, which has now spread across two administrations, has largely paralyzed private sector investment, and if the uncertainty continues we could see a further decline in private sector production.

Comment

¶10. (SBU) With last year's heavy-handed interference by the Palacio administration, it was to be expected that oil production would suffer, given that the private sector has been the dynamic half of Ecuador's petroleum industry. There are already dramatic indications of the consequences of those actions, and we don't see any signs that the current government will take actions to reverse

the trend. The Correa government rhetoric suggests that it might even exacerbate the problem, but given inconsistent signals elsewhere in the economy, it's hard to predict how this government will proceed in the oil sector.

¶11. Falling oil production will clearly hamper Ecuador's economic growth and trade balance. However, for at least the next few years, government petroleum revenues will be higher than they otherwise would have been as a result of seizing the Oxy fields and forcing additional revenue sharing. Even so, given weaker oil prices and declining production, the government's petroleum revenues are now going to start declining from this "high point."

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